

IN THE INCOME TAX APPELLATE TRIBUNAL  
MUMBAI BENCHES "G"

**BEFORE SHRI P.M. JAGTAP, A.M. AND SHRI VIJAY PAL RAO, JM**

**ITA No. 1090/Mum/09**  
Assessment Year 2005-06

M/s Godrej Industries Ltd., C/o Kalyaniwalla & Mistry, Kalpataru Heritage, 127 Mahatma Gandhi Road, Mumbai. 400 001. PAN AAACG2953R	Vs.	D.C.I.T. Rg. 10(2), 4 <sup>th</sup> Fl., Aayakar Bhawan, M.K. Road, Mumbai 20.
Appellant		Respondent

Appellant by	Shri F.V. Irani
Respondent by	Mrs. Neeraj Vinay Bansal

**ORDER**

**PER P.M. JAGTAP, A.M.**

This appeal by the assessee is directed against the order of Id. CIT(A) X, Mumbai dated 23.1.09.

2. Ground No. 1 to 6 raised in this appeal involve a common issue relating to the disallowance made by the A.O. and sustained by the Id. CIT(A) out of interest expenses and other expenses by invoking the provisions of section 14A read with Rule 8D.

3. The assessee in the present case is a company which is engaged in the business of manufacturing and/or trading in soaps, detergents, industrial chemicals etc. It is also engaged in the business of shares and securities and derives income from leasing properties. The return of income for the year under consideration was filed by assessee company on 29.10.05 declaring total income of ₹ 'nil' as per the normal provisions of the Act and book profit of ₹ 53,32,12,325/- u/s 115JB. During the year under consideration,

the assessee company had earned dividend income of ₹ 21,73,85,180/-from shares and mutual funds which was claimed to be exempt u/s 10(34) and 10(35). According to the A.O., interest as well as some of the administrative expenses incurred by the assessee to the extent attributable to earning of such exempt income were liable to be disallowed as per the provisions of section 14A. He, therefore, required the assessee to explain why such disallowance on account of the said expenses should not be made as per the provisions of section 14A. In reply, a detail submission was made on behalf of the assessee company which, as summarized by the A.O. in para 4.2 of his order was as under:-

“(i) That it did not incur any specific expenditure in earning the dividend, no specific borrowing or expenditure as attributable to investment activities. Hence, no expenditure can be apportioned towards earning of dividend income in the year under consideration.

(ii) That the assessee company has borrowed funds solely for the purposes of carrying out its business activities, and not for the purpose of investment in shares. Such loans have been utilized to acquire immovable properties, fixed assets and for the day to day business operations of the company.

(iii) That the total investment as on 31.03.2005 is itself far below the total sale proceeds of investments and dividend received during the past ten years. The investments on which the exempt dividend has been received during the year is not out of borrowings but out of plough back of sale proceeds and investment income of the investments made in the earlier years. Hence, no interest expenditure is attributable to this.”

4. In view of the above submission, it was contended on behalf of the assessee before the A.O. that interest expenditure incurred by it was not at all attributable to earning of dividend income and no disallowance out of the same could be made u/s 14A.

5. The A.O. did not find merit in the submissions made on behalf of the assessee company. According to him, although the assessee is claimed to have made the investment in shares out of surplus funds, it could have utilized the said payments for repaying the borrowing instead of making investment in shares. He held that it was thus an in-direct case of diversion of borrowed funds by the assessee for making investment in

shares so as to earn dividend income and since such dividend income was exempt from tax, interest attributable to the borrowed funds utilized for making investment in shares was liable to be disallowed u/s 14A. For this conclusion, he relied on the decision of Hon'ble Punjab & Haryana High Court in the case of CIT vs. Abhishek Industries Ltd. 286 ITR 1. He also noted in this context that the assessee company had own capital and reserve funds of ₹ 335.36 crores as against investment in shares made at ₹ 335.77 crores as on 31.3.05. He further noted that the ratio of borrowed funds to the total funds as on 31.3.05 was 43.26% and applying the said ratio, he held that the borrowed funds to the extent of ₹ 145.25 crores were utilized by the assessee for making investment in shares/mutual funds. He also worked out the ratio between investment out of borrowed funds and the borrowed funds at 56.79% and applying the said ratio, he disallowed interest expenditure of ₹ 17.45 crores to the extent of ₹ 9.91 crores u/s 14A. He also held that 5% of the total remuneration of ₹ 4,09,67,078/- paid by the assessee company to its directors was attributable to earning of dividend income and a sum of ₹ 20,48,350/- therefore was disallowed by him out of remuneration to directors u/s 14A. Out of the remaining administrative and establishment expenses, he presumed that a sum of ₹ 5 lacs was incurred in respect of earning of dividend income and accordingly a total disallowance out of expenses to the extent of ₹ 25,48,350/- was made by him u/s 14A in addition to ₹. 9.91 crores made on account of interest expenses. On appeal, the Id. CIT(A) upheld the action of the A.O. in invoking the provisions of section 14A to make the disallowance out of interest and other administrative expenses. He, however, restricted the quantum of such disallowance made by the A.O. to ₹ 6.43 crores by applying Rule 8D of the Income Tax rules 1962 inserted w.e.f. 1.4.08.

6. We have heard the arguments of both the sides and also perused the relevant material on record. As held by the Hon'ble Bombay High Court in the case of Godrej Boyce Mfg. Co. Ltd. (ITA No. 626 of 2010 dtd. 12.08.2010), Rule 8D of the Income Tax Rules 1962 is applicable only prospectively i.e. from A.Y. 2008-09. Since the assessment year involved in the present case is 2005-06, respectfully following the said

judgment of the Hon'ble Bombay High Court, we hold that the Id. CIT(A) was not justified in applying the said Rule to quantify the disallowance u/s 14A.

7. As regards the disallowance made out of interest expenditure by invoking the provisions of section 14A, it is observed that elaborate submissions were made on behalf of the assessee before the A.O. as well as before the Id. CIT(A) to establish that the investment in shares was made out of its own funds and the borrowed funds were entirely utilized for the purpose of its business. At the time of hearing before us, the Id. Counsel for the assessee has taken us through the copies of such submissions placed in his paper book to demonstrate that the entire amount of borrowed funds was utilized for the purpose of its business by the assessee company and the investment in shares was made by it out of its own funds. As pointed out by him from the assessment orders for the earlier years including the assessment order passed for the immediately preceding year i.e. 2004-05, the A.O. himself had accepted after verification of the relevant record that the borrowed funds were entirely utilized by the assessee for the purpose of its business and investment in shares was made by it out of its own funds. As further pointed out by him from the copy of fund flow statement for the year under consideration placed at page 19 of the paper book, funds to the tune of ₹ 46 crores were generated from operation of the assessee company which were more than the net investment of ₹ 40.60 crores made in that year. He has pointed out that the finding given by the A.O. in his order that total investment made by the assessee company in shares at ₹ 335.77 crores as on 31.5.05 was more than its own capital and reserves amounting to ₹ 335.36 crores is factually incorrect. In this regard, he invited our attention to the relevant portion of the written submission filed before the Id. CIT(A) placed at page No. 3 of his paper book to point out that out of the total investment of ₹ 335.77 crores made in the shares, investment of ₹ 19.31 crores was made in the shares of foreign companies, the dividend income of which was liable to tax in India. He submitted that investment of ₹. 316,46 crores only thus was made in the shares of domestic companies, the dividend income of which was exempt from tax u/s 10(34) and the assessee had sufficient own funds of ₹ 335.36 crores in the form of own

capital and reserve to make the said investment as accepted even by the A.O. Keeping in view this submissions made by the Id. Counsel for the assessee, we find that sufficient evidence was brought on record by the assessee company to establish that investment in shares was made by it out of its own funds and the borrowed funds were entirely utilized for the purpose of its business. As a matter of fact, even the authorities below have not disputed this position. According to them, the assessee, however, could have utilized its surplus funds for repaying the borrowings instead of investing in shares and by not doing so, there was diversion of borrowed funds towards investment in shares to earn dividend income. For this conclusion, reliance was placed by the Revenue Authorities on the decision of Hon'ble Punjab & Haryana High Court in the case of CIT vs. Abhishek Industries Ltd. (supra). In the case of CIT vs. Hero Cycles Ltd. 323 ITR 518 cited by the Id. Counsel for the assessee, a similar stand was taken by the Revenue relying on the decision of Hon'ble Punjab & Haryana High Court in the case of Abhishek Industries Ltd. (supra) in the context of disallowance of interest expenditure u/s 14A. The Hon'ble Punjab & Haryana High Court, however, did not accept this contention raised on behalf of the Revenue observing that the judgment of Abhishek Industries Ltd. (supra) was on the issue of allowability of interest paid on loans given to sister concerns without interest. It was held that the relevant observations recorded in the said judgment therefore have to be read in that context. In the case of Hero Cycles Ltd. (supra), a finding was recorded by the Tribunal that the investment in shares and funds was made by the assessee out of the dividend proceeds and not out of borrowed funds and in view of this finding of fact, it was held by the Hon'ble Punjab & Haryana High Court that the disallowance u/s 14A was not sustainable. Keeping in view the said decision of the Hon'ble Punjab & Haryana High Court in the case of Hero Cycles Ltd. (supra) and having regard to the facts of the case, we hold that the disallowance made by the A.O. out of interest expenses u/s 14A and confirmed by the Id. CIT(A) is not sustainable. The same is therefore deleted.

8. As regards the issue relating to the disallowance out of common administrative expenses u/s 14A , it is observed that this disallowance made by the A.O. at ₹ 25,48,350/-

was enhanced by the Id. CIT(A) to ₹ 1,40,52,000/- by applying Rule 8D of Income Tax rules 1962. As held by the Hon'ble Bombay High Court in the case of Godrej Boyce Mfg. Co. Ltd. (ITA No. 626 of 2010 dtd. 12.08.2010), Rule 8D of the Income Tax Rules 1962 is applicable only prospectively i.e. from A.Y. 2008-09. As further held by the Hon'ble Bombay High Court in the said case, the quantum of disallowance u/s 14A for the years earlier to A.Y. 2008-09 has to be worked out by adopting some reasonable method. In this context, the Id. Counsel for the assessee has submitted that in the earlier years, a similar disallowance made by the A.O. has been sustained by the Id. CIT(A) to the extent of 5% of the total exempt income earned by the assessee and the same being reasonable, the assessee has accepted it. We, therefore, sustain the disallowance made by the A.O. and confirmed by the Id. CIT(A) out of other administrative expenses u/s 14A to the extent of 5% of the total exempt income. Ground No. 1,2,5 & 6 of the assessee's appeal are accordingly allowed whereas ground No. 3 & 4 are partly allowed.

9. As regards ground No.7, it is observed that the issue involved therein relating to disallowance amounting to ₹ 1,16,125/- made by the A.O. and confirmed by the Id. CIT(A) on account of amortization of premium paid by the assessee for leasehold land is squarely covered against the assessee by the orders of the Tribunal in assessee's own case for earlier years i.e. A.Y. 2000-01 to 2003-04. Respectfully following the said orders of the Tribunal, we confirm the disallowance made by the A.O. and sustained by the Id. CIT(A) on this issue and dismiss ground No. 7 of the assessee's appeal.

10. As regards ground No. 8, it is observed that the issue involved therein relating to assessee's claim for depreciation on the opening written down value of the block of assets as per the appellate order for immediately preceding assessment year is also squarely covered against the assessee by the decision of the Tribunal in assessee's won case for A.Y. 2003-04 rendered vide its order dated 30.9.2008 in ITA No. 4197/Mum/06 wherein a similar claim of the assessee has been disallowed by the Tribunal. Respectfully

following the said decision of the Tribunal, we uphold the impugned order of the ld. CIT(A) on this issue and dismiss ground No. 8 of the assessee's appeal.

11. In the result, appeal of the assessee is partly allowed.

Order pronounced on 8<sup>th</sup> October, 2010.

Sd/-  
(VIJAY PAL RAO)  
JUDICIAL MEMBER

sd/-  
(P.M. JAGTAP)  
ACCOUNTANT MEMBER

Mumbai, dated 8<sup>th</sup> October , 2010.

RK

Copy to...

1. The appellant
2. The Respondent
3. The CIT(A) G - Mumbai
4. The CIT- X Mumbai
5. The DR Bench, G
6. Master File

// Tue copy//

BY ORDER  
DY/ASSTT. REGISTRAR  
ITAT, MUMBAI

	Date	Initials	
1. Draft dictated	27.9.10, 5.10.10		Sr.P.S./P.S.
2. Draft placed before author	4.10.10, 5.10.10		Sr.P.S./P.S.
3. Draft proposed & placed before the second member.	-		J.M./A.M.
4. Draft discussed/ approved by second Member.			J.M./A.M.
5. Approved draft comes to the Sr.P.S./P.S.			Sr.P.S./P.S.
6. Kept for pronouncement on			Sr.P.S./P.S.
7. File sent to the Bench Clerk			Sr.P.S./P.S.
8. Date of which file goes to the Head clerk.			
9. Date of dispatch of order.			